United States Court of Appeals

for the Second Circuit

PETITION FOR REHEARING EN BANC

75-1153

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket No. 75-1153

UNITED STATES OF AMERICA,

Appellee,

—v.—

JACKSON D. LEONARD,

Defendant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

ANSWER FOR THE UNITED STATES OF AMERICA TO POINT III OF THE PETITION FOR REHEARING WITH SUGGESTION FOR REHEARING EN BANC

PAUL J. CURRAN,
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W. CULLEN MACDONALD,
JOHN C. SABETTA,
Assistant United States Attorneys, Of Counsel.

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ANSWER FOR THE UNITED STATES OF AMERICA TO POINT III OF THE PETITION FOR REHEARING WITH SUGGESTION FOR REHEARING EN BANC

Preliminary Statement

Judgment of conviction was entered as to Jackson D. Leonard on March 7, 1975, in the United States District Court for the Southern District of New York after a seven day trial before the Honorable Richard Owen, United States District Judge, and a jury.*

On August 28, 1975, this Court (Moore, Friendly and Van Graafeiland, *C.JJ.*) rendered its decision affirming the judgment of conviction.

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* For a complete statement as to the charges in the indictment, the jury's verdict and the sentence imposed by Judge Owen, see the Preliminary Statement of the government's brief on appeal.

On September 11, 1975 Jackson D. Leonard filed a petition for rehearing with suggestion for rehearing en banc. On September 22, 1975, this Court ordered the government to file an answer to Point III of defendant Leonard's petition.

ARGUMENT

POINT III

Neither the books of account nor the signed tax return prove that Leonard's Subchapter S corporation suffered a loss during calendar year 1968. Leonard's proof and his request to charge failed to take this into account.

Leonard claims that three exhibits established that his Subchapter S corporation, Leonard Process Co., Inc. (hereafter Leonard, Inc.) had no earnings and profits in its 1968 fiscal year from which taxable dividends could have been paid and, accordingly, it was error for the District Court to have refused to enter a judgment of acquittal on Count Two. The argument remains incorrect.

As a factual matter, Leonard must, of necessity, ignore the variance between the Leonard, Inc. tax year originally elected—calendar 1968—and that appearing in the corporate returns for the twelve months ending January 31, 1969, despite the absolute prohibition forbidding such unilateral changes. Whether the profitability of Leonard, Inc. for calendar 1968 would have been the same or by some amount different from that for the period ending January 31, 1969 is a subject which Leonard chose not to pursue by calling an appropriate witness. Undoubtedly, the Leonard, Inc. books could have been closed as of December 31, 1968, and upon the inclusion of his January 1968 proprietorship results, a

recomputation of profitability for calendar 1968 could have been undertaken. Leonard elected, however, not to prove such results. Instead, he rested his defense on his claim that his accountant, Leskowicz, was not authorized to sign Leonard's 1968 individual return. That return, of course, failed to report any income or loss by Leonard, Inc., or Leonard's receipt of any nontaxable distributions from it (see other Subchapter S corporate results reported by Leonard in Schedule B, Part III of GX 2 at E. 41; see also Part II, 1d for "Nontaxable distributions" of GX 2 at E. 40).* Accordingly, neither Judge

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* Leonard's decision to refrain from calling the preparer of Leonard, Inc's tax returns—who could have authenticated them—was clearly not mere happenstance. That individual, if called, would have been required to explain who reduced Leonard, Inc.'s stated income for the pertinent period by $40,000 by switching $40,000 from the "Fees" column to a "Misc." receipt labeled "loan" (compare GX 87A at E. 391 with Bardes' original draft which immediately follows it in GX 87 (attached hereto as Addendum "A") and with the corresponding checkbook stub GX 88A in GX 88 (attached hereto as Addendum "B")), thereby raising the originally calculated corporate loss from $29,017.77 (GX 94 at E. 465) to $73,742.33 (DX X at E. 559) for even the year ending January 31, 1969. Leonard's declination to call the authenticating preparer cannot be undone simply because his own signature appears on the original of that latter return (DX Y at E. 564). Without the authenticating preparer, the returns remained inadmissible. *See Standard Oil Co. of California* v. *Moore*, 251 F.2d 188, 222-223 (9th Cir. 1957), *cert. denied*, 356 U.S. 975 (1958). Apparently Leonard's counsel recognized this since at the time of the offer, he said that he did not "necessarily offer the first" (A. 977) page bearing Leonard's signature.

Of course, if Leonard, Inc. had suffered a loss of $29,017.77 rather than $73,742.33, the distribution of $52,455.22 to Leonard during the months of 1968, save for January, would have resulted in taxable income to Leonard of more than $23,000—hardly immaterial. The amount of the taxable distribution might even be greater if the profitability of Leonard, Inc. for January 1968 is also considered—given, among other things, the receipt by Leonard, Inc. that month of $6,229.20 in override payments.

Owen nor the jury had sufficient information from which to make any findings "as a matter of law" as to whether the character of the funds received was: (i) a "distribution which is a dividend" (IRC §§ 301(c)(1), 316); (ii) a "distribution which is not a dividend" (IRC § 301(c)(2)) but which, to the extent that it exceeded Leonard's adjusted basis, still qualified "as a gain from the sale or exchange of property" (IRC §§ 301(c)(3)(A), 1016(a)(3)); or (iii) a distribution constituting a return of capital during calendar 1968 and therefore nontaxable.* In short, none of the three exhibits said to have been overlooked, proves anything like the claim of a loss which converts the diverted funds into a tax free return of capital.

We respectfully suggest that in the context of a criminal proceeding, *Davis* v. *United States*, 226 F.2d 331 (6th Cir. 1955), is the leading case on this issue. It rejects any supposed burden on the part of the government to prove the profitability of a corporation from which a defendant shareholder embezzles funds. That decision flatly held that the government need not prove corporate profitability and retained earnings in order to

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* Of course, Leonard could have selected a less thinly capitalized corporate structure than either of those shown on the returns ($100 capital and $94,900 in loans from shareholders (DX X at E. 562 and DX Y at E. 567), or $100 capital and $54,900 in loans from shareholders (GX 44 at E. 469))—in which case his return of capital argument would be unavailing to the extent distributions to him were in excess of his adjusted basis. Moreover, had Leonard, Inc.'s books been closed on December 31, 1968, rather than January 31, 1969, the loans then payable (see GX 87 account 204) would have been either $20,000 or $60,000 (depending, of course, upon the treatment of the $40,000 receipt of Oct. 22, 1968). Accordingly, assuming the same $100 adjusting debit to capital and $20,000 in loans repayable (GX 87—Journal, p. "J-1"), approximately $38,000 of the override payments could not properly be said to have been loan repayments.

charge a defendant stockholder with failing to report those of his diversions which he treated as his own. Our research discloses that it has been approved by the only other circuit court squarely to consider the issue in the criminal context. *See Hartman* v. *United States* 245 F.2d 349 (8th Cir. 1957). It should not be now rejected —particularly in light of the peculiar circumstances of this case.

DiZenzo v. *C.I.R.*, 348 F.2d 122 (2d Cir. 1965), is not authority for Leonard's argument that he was entitled to have his Request To Charge E read to the jury. Leonard's requested charge switched the burden of proof to the government without even the slightest suggestion in *DiZenzo* that such might be appropriate in criminal cases. Additionally, in *DiZenzo* the corporation's returns had been filed for all of the disputed years. Here, in contrast, the financial position of Leonard, Inc. has never been disclosed or declared in any fashion— neither in the corporate minutes (DX AJ) nor in the required report of distributions "from sources other than earned surplus" (N.Y. Bus. Corp. Law § 510(c)). Here, even more so than in *Holland* v. *United States*, 348 U.S. 121 (1954), the government simply does not bear the endless burden of proving every conceivably relevant negative depending upon the course of the trial. If and when a Subchapter S taxpayer embezzles funds from a small business corporation properly identified in his individual tax return as having a loss or gain to be passed through to him under IRC § 1374(a), and fails also to report his receipt of such diversions, a closer case may be presented for requiring the government to go forward. In any event, Leonard's request was far too broad under any approach.

CONCLUSION

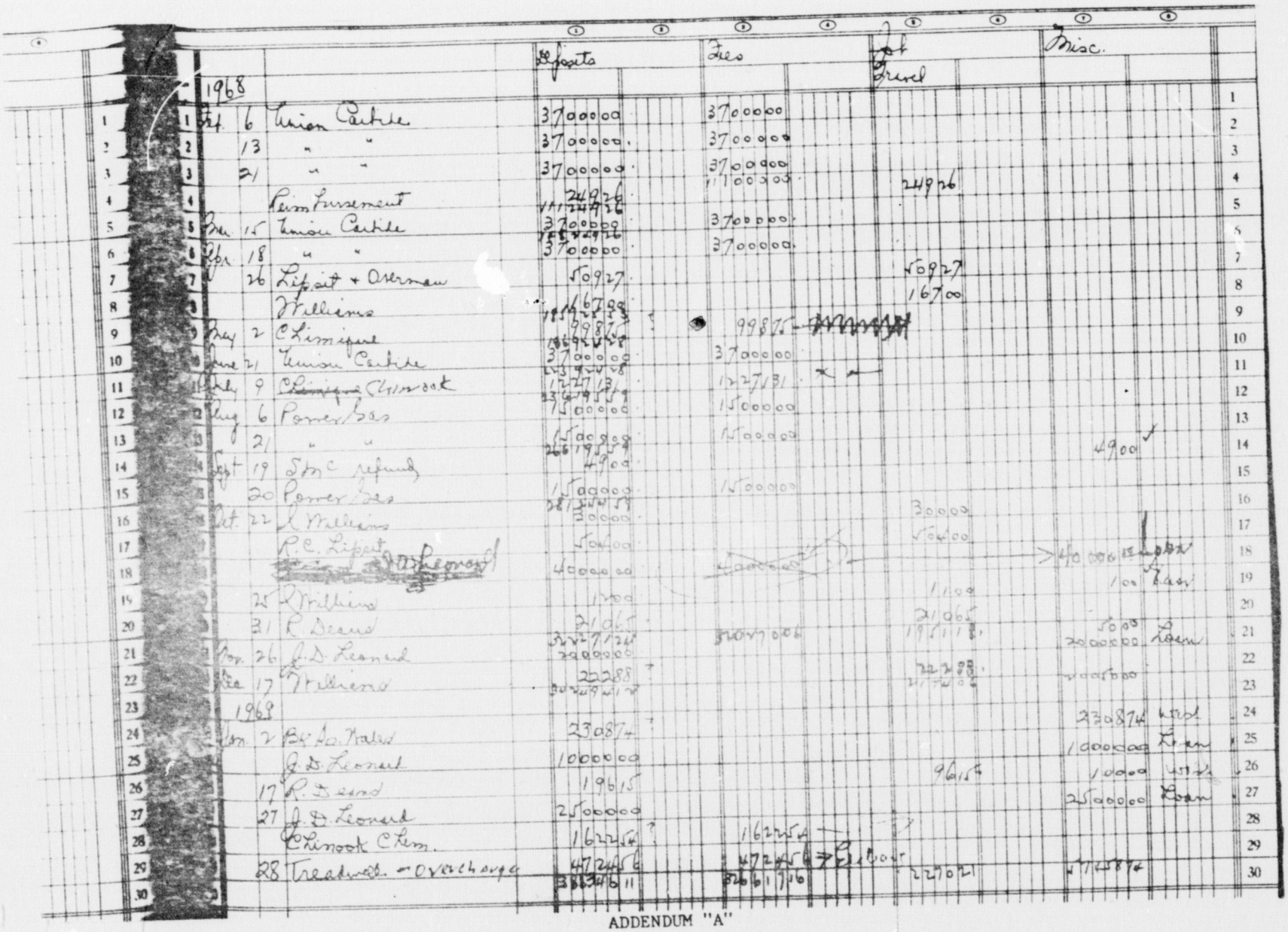
The petition for rehearing with suggestion for rehearing en banc should be denied.

Respectfully submitted,

PAUL J. CURRAN,
United States Attorney for the Southern District of New York, Attorney for the United States of America.

W. CULLEN MACDONALD,
JOHN C. SABETTA,
Assistant United States Attorneys, Of Counsel.

ADDENDA



ADDENDUM "A"

Bardes' original draft of Cash
Received by Leonard, Inc.
(GX 87)

[*For the Convenience of Court and Counsel this Addendum is printed on the opposite page*]

3a

DATE	DEPOSITS		
	BALANCE FORWARD	10,060	07
10/22 68	[redacted] Loan from JDL	40,000	–
		50,060	07
	–		10 (see upte ck. 475)
		50,059	97
	+	1,000	00 (see upte ck. 475)
		51,059	97

USA 33a - 475
(ED. 4-23-71)

GOVERNMENT
EXHIBIT
U. S. DIST. COURT
S. D. OF N. Y.

88A

TOTAL DEPOSITS	51,059	97
TOTAL CHECKS DRAWN	1,025	53
BAL. CARRIED FORWARD	50,034	44

✓ NO. 524
10/22 1968
St. Charles Garage
Parking –
65 – 00

✓ NO. 525
10/22 1968
ITT World Communications
Cables
91 85

✓ NO. 526
10/23 1968
Internal Revenue Svc
Fed. quarterly report
on tax paid
up to Sept 1968
868 68

FIRST NATIONAL CITY BANK
1025 53

ADDENDUM "B"

Checkbook Stub
(GX 88A)

AFFIDAVIT OF MAILING

STATE OF NEW YORK)
) ss.:
COUNTY OF NEW YORK)

JOHN C. SABETTA, being duly sworn, deposes and says that he is employed in the office of the United States Attorney for the Southern District of New York.

That on the 9th day of October, 1975 he served 2 copies of the within brief by placing the same in a properly postpaid franked envelope addressed:

James Schreiber, Esq.
Walter, Conston, Schurtman & Gumpel, P. C.
330 Madison Avenue
New York, New York 10017

And deponent further says that he sealed the said envelope and placed the same in the mail drop for mailing at the United States Courthouse, Foley Square, Borough of Manhattan, City of New York.

John C. Sabetta

Sworn to before me this

9th day of October, 1975

Jeanette Ann Grayeb

JEANETTE ANN GRAYEB
Notary Public, State of New York
No. 24-1541575
Qualified in Kings County
Commission Expires March 30, 1977